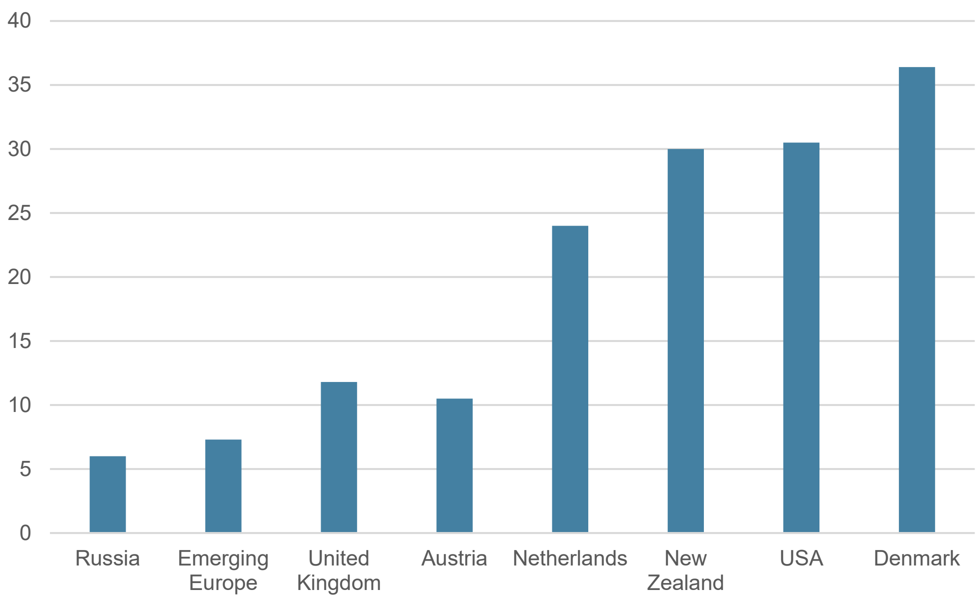
# Perpetual Wealth Monitor

January 2021.

# Executive Summary

- We expect the world economy to grow around 4.5% in 2021.
- But the second wave of the pandemic and associated lockdown measures will slow down economic growth in the northern hemisphere in coming months.
- The distribution of numerous vaccines has begun. The pandemic should be over by mid-2021. Until then, we expect discussions of further fiscal rescue packages in most regions.
- An end to lockdowns and ongoing, aggressive monetary and fiscal stimulus suggest a strong economic recovery over the course of 2021, possibly beginning as early as the second quarter.
- Yields on many government bonds have continued to show little movement. Meanwhile, some $18 trillion worth of bonds are now trading on a negative yield.
- We expect a significant recovery in corporate earnings in 2021. But share prices already seem to anticipate a lot of positive news.
- The US dollar is likely to remain under pressure. The Fed will maintain its loose monetary policy.
- Precious metal prices are consolidating following their setback.

**Selected cyclically adjusted price-earnings ratios**




**Source: Thomson Reuters / Datastram and own calculations**

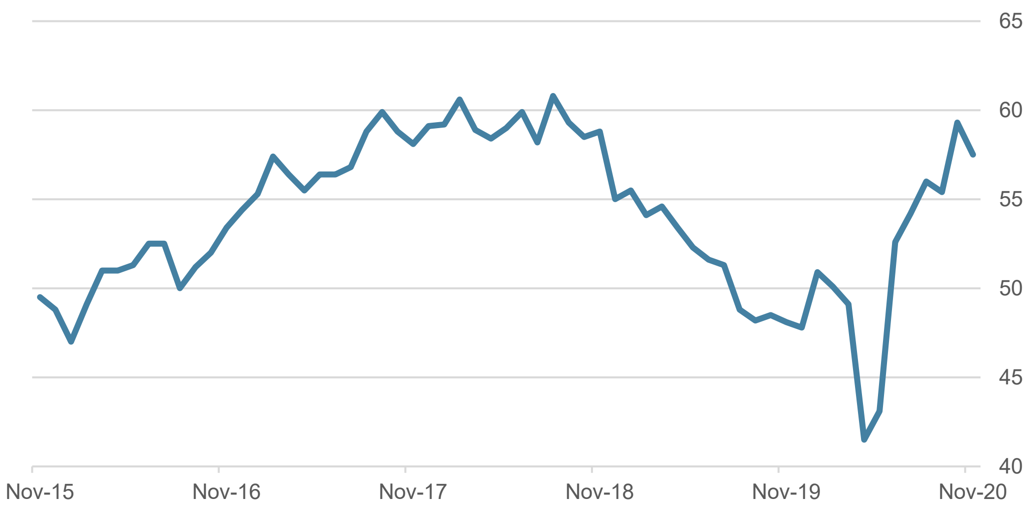
**Big differences in stock market valuations**

- Many look at the price-earnings (P/E) ratio to determine the attractiveness of a share. This is the relationship between the price of a share and the earnings which theoretically accrue to the shareholder. However, it is a crude measure, helpful only in making broad assessments about value.
- More meaningful is the so-called Shiller P/E ratio, which does not look at the current profit situation but is based on the average of inflation-adjusted corporate profits over the previous ten years. For an investor, the figure says nothing other than how many dollars an investor must pay for one dollar of “sustainable profit”.
- In the past, this ratio has shown good forecasting properties for investment returns over the long term. However, it is less effective at forecasting market movements over the short and medium-term.
- The chart on the left shows the “cheapest” and “most expensive” equity markets based on the Shiller PE valuation method. Denmark, the USA and New Zealand are the most expensive markets shown there. Russia, Emerging Europe and the UK are among the most cheaply valued markets. The British stock market has a particular potential for recovery if Brexit negotiations are concluded successfully.
- The spread of valuation levels across markets is currently substantial. The high valuation of the world equity index is mainly due to the very high index weight of the US market (around 50%). Many global market leaders such as Alphabet, Facebook, Apple, Amazon and Microsoft have relatively high trend growth rates and are accordingly expensive. The high valuation of such companies is at least partly justified.

# Business Cycle

**Germany: Ifo Business Climate Index - Expectations, last 10 years**


**USA: ISM Purchasing Managers' Index for Manufacturing, last 5 years**



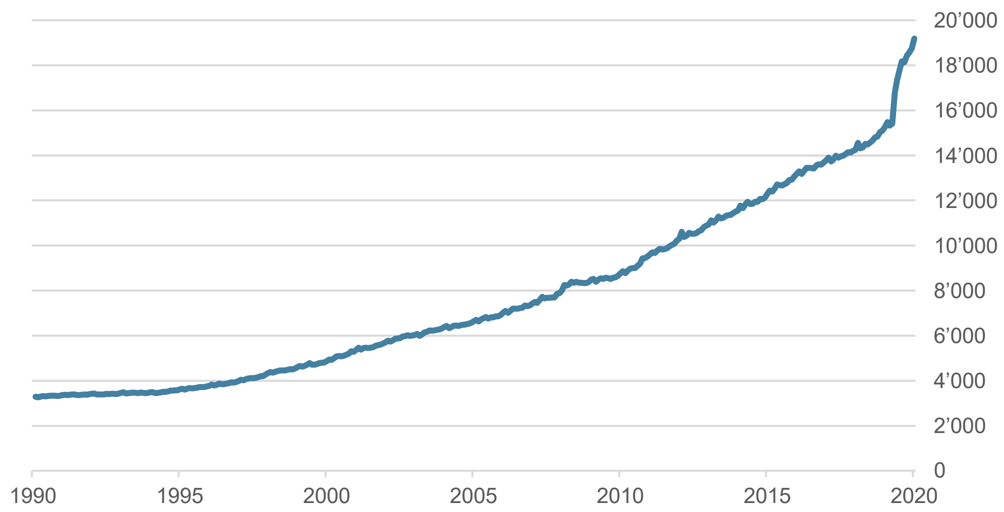

**Source: Bloomberg Finance L.P.**

**Light at the end of the tunnel**

- We expect global economic growth of +4.5% in 2021. Other growth forecasts for 2021 are as follows - USA: +4%, EU: +5.0%, Japan: +2.5%, China: 8%, UK: +5.5%, Switzerland +3%.
- In the US, the process of formal handover to the Biden Administration has begun. Meanwhile, further progress has been made on the vaccine front. The first regular vaccinations, not related to testing, have already taken place.
- In contrast to Europe and the US, the pandemic in China and Asia has been largely under control for months. As a result, the gap in economic growth rates between emerging market and western industrial countries has widened.
- The Ifo business climate index indicates the upswing in Germany has stalled. But in recent months purchasing managers' indices for the US have managed to stay at high levels.
- 15 countries from Asia and the Pacific have concluded a new free trade agreement, the Regional Comprehensive Economic Partnership (RCEP). This should provide an additional growth impetus to China, large parts of Asia, especially Southeast Asia, and Australia.
- The size of a future fiscal stimulus package in the US depends, among other things, on whether the Democrats succeed in winning the two Senate seats up for election in Georgia on January 5th.
- Some of the emergency programs, set up in the spring to combat the economic consequences of the pandemic, have been allowed to expire by the Trump Administration. Thus, for some companies, there is currently no longer an effective safety net protecting them against a significant risk of insolvency. It is therefore vital that the US Congress acts quickly to pass a fresh rescue package.
- Even a watered-down version of the Democrat stimulus program, if it is passed soon in the new year, should be enough to enable a strong economic recovery from the second quarter of 2021 at the latest. First, however, the peak of the second pandemic wave must be passed, and right now the Covid situation in the US looks particularly bad.
- Rescue packages are less about stimulating demand than the prevention of household and corporate bankruptcies. That is also why they will be effective; a significant "crowding-out", such as might lead to weaker private investment, is unlikely to happen.

# Monetary Policy

**USA: M2 money supply in billions of US dollars, since 1990**




**USA - Inflation expectations (based on 5-year swaps)**

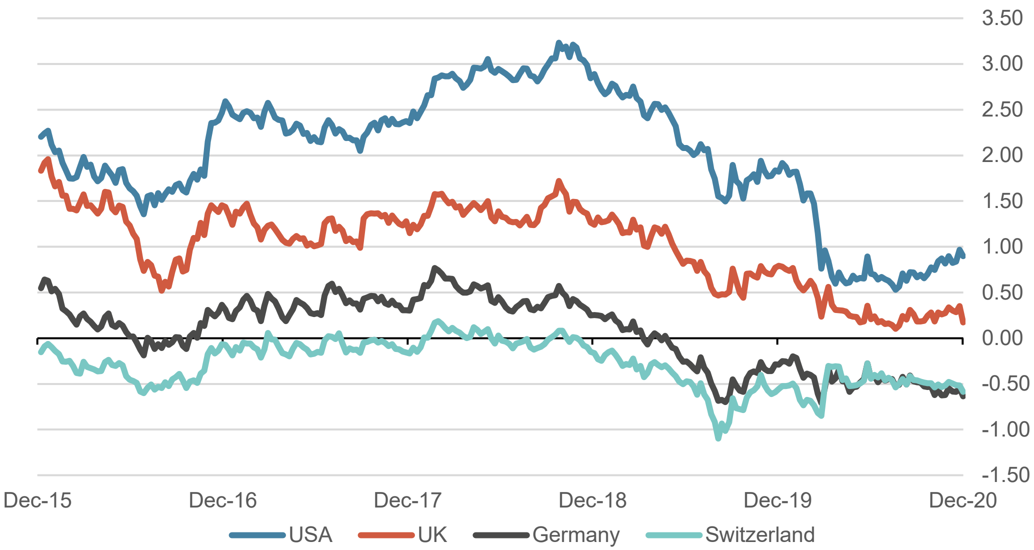

**Monetary policy makers call for increased government spending**

- In 2020, the monetary floodgates have been opened more quickly and more aggressively than ever before. Practically all central banks have clearly exceeded their policy mandates, implementing easing measures that regulatory considerations made unthinkable just a few years ago. For example, the Fed has acted like a normal commercial bank in providing companies with short term financing.
- In order to forestall an impending wave of insolvencies, all major central banks have started to buy the bonds of companies with poor credit ratings. Since most major central banks now have interest rates at or below zero, traditional easing through further interest rate cuts is no longer possible (unless cash is abolished). Central banks will therefore have to maintain their unconventional ways of delivering ultra-loose monetary policy in 2021.
- The European Central Bank (ECB) announced in December that it would increase its balance sheet expansion program by 500 billion euros (or by about 35%). Originally, some members of the ECB board were even calling for a 750 billion-euro expansion.
- The ECB has also increased its "Targeted Longer-Term Refinancing Operations" program. Commercial banks can now borrow up to 55% of their outstanding loans from the ECB under special conditions.
- But such additional measures increasingly require the support of fiscal policy. First and foremost, government rescue packages are not now being called for in order to stimulate demand but rather to prevent insolvencies. Fiscal stimulus is being "financed" by the central banks to prevent interest rates from rising, as this might otherwise "crowd out" private investment.
- The growth rate of US monetary aggregate, M2 (cash, demand and time deposits) has increased significantly. This has boosted inflation expectations.
- The Fed is "waiting" with additional easing measures until Congress passes the next Corona virus rescue package. The longer this takes, the larger the package will have to be and the larger the likely expansion of the Fed's balance sheet that will result.
- Despite the enormous surge in money creation, no strong increase in inflation is expected for the immediate future. But longer-term inflation expectations have already risen.

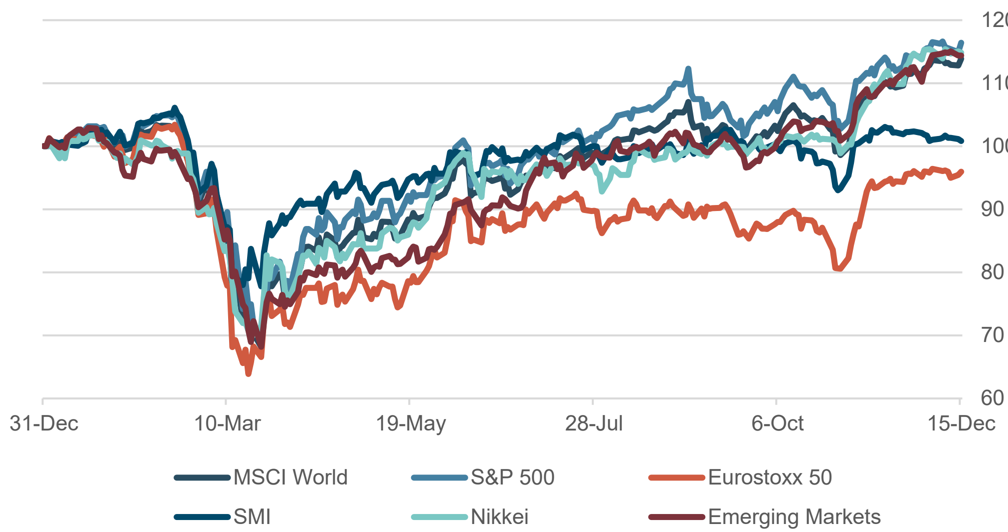
Source: Bloomberg Finance L.P.

# Asset classes – Bonds and equities

**10 year government bond yields in %, last 5 years**




**Equity markets, indexed performance, year to date**




**Source: Bloomberg Finance L.P.**

### Little movement in bonds

- Yields on government bonds in the most important markets are under control from the central banks' point of view. The market's pricing mechanism has been eliminated and thus there is no risk that reckless borrowers will get "punished" via rising yields. Worldwide, bonds with a total nominal value around 18 trillion US dollars are now trading on negative yields.
- The dimensions of the various central bank purchase programs, and of state refinancing needs that result from massive fiscal stimulus, make this essential.
- This trend is leading to "creeping death" for the bond markets: central banks under the clear leadership of Japan now hold between 35% and 90% of outstanding government bonds. And the first tendencies towards market domination by the state can also be seen in the area of corporate bonds. The result is that securities become less liquid, which leads in turn to "bottlenecks" in the investment process. Credit spreads for corporate bonds with investment grade ratings are currently trading at levels seen at the beginning of 2020.

### Optimism on the stock markets

- Positive developments regarding Corona vaccines have triggered a very buoyant mood in stock markets over the last few weeks. Widespread optimism is expressed in sentiment indicators, some of which are close to extreme readings. For example, bull-bear indicators, call-put ratios and the CNN Fear & Greed index are back at February levels.
- A whole series of IPOs (e.g., AirBnB, Doordash, etc.) from companies that are far from generating profits have found their way to the market in its present euphoric state. In some cases, these new stock offerings have initially traded at over 100% above the issue price. This phenomenon brings back memories of the winter of 1999/2000 - shortly before the bursting of the "tech bubble".
- In general, it can be said that the equity markets are currently prepared to ignore all potentially negative factors (renewed lockdowns, Brexit, a delay in the US aid package, the geopolitics of Iran, the election in Georgia, tensions between the USA and China to name but a few). The focus is clearly on an economic recovery, and a corresponding increase in corporate profits, in the coming year.
- We view short-term setbacks in the stock markets as an opportunity for additional purchases. In the medium term, the attractiveness of equities as real assets remains a significant support.

# Asset classes – Currencies and other assets

**USD/CHF, last 2 years**


### US dollar weakens

- The US dollar has come under increasing pressure in recent days and is trading at multi-year lows. Expectations not only of a US aid package in the near term but also of subsequent packages to support the economy are the reason for this. In this respect, the US dollar - much like the US bond market - is not giving the same optimistic message as the US stock market.
- This starting position is again putting pressure on the other central banks to try to weaken their appreciating currencies. Paradoxically, last week's ECB meeting and the gigantic measures announced (the increase in QE, the expansion of TLTRO) were interpreted by the foreign exchange market as indicating ECB weakness, in the sense that "the ECB is at the end of its tether".
- The Chinese central bank is, behind the scenes, effectively and calmly counteracting the appreciation of the yuan through short-term liquidity injections.

**Gold price, US dollars per ounce, last 5 years**


### Precious metals in consolidation mode

- The "narrative" pushing up the stock markets has led to a substantial correction in precious metals markets. The gold price has lost about 12% since its August peak. Mining stocks have also come under strong pressure.
- Surprisingly, this correction came about without any significant movement in the US dollar or any trend to "less negative" real US interest rates. In other words, inflation expectations have retreated only marginally, because nominal yields are virtually unchanged. Interestingly, the cryptocurrencies have behaved in exactly the opposite way. Indeed, the appreciation of cryptocurrencies is arguably more logical given the unsustainable growth of the money supply.
- We are strongly of the view that current precious metals prices represent a buying opportunity as we expect all central banks, sooner or later, will take further and stronger measures to push down real interest rates.

**Source: Bloomberg Finance L.P.**

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